



## Draft Proposal #3

### Simplify Ownership of PUV Property

#### BILL ANALYSIS

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<b>Committee:</b>	Revenue Laws	<b>Date:</b>	April 1, 2008
<b>Introduced by:</b>		<b>Summary by:</b>	Martha Walston
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**SUMMARY:** *The draft simplifies the ownership requirements of present-use value property and allows property to remain in present-use value if the owner pays deferred taxes at the time of transfer and the new owner continues to farm the land and files an application for present-use value status.*

**CURRENT LAW:** Since 1973, the General Assembly has provided special property tax treatment for farmland that is classified and used for agricultural, horticultural, or forest purposes.<sup>1</sup> If the farmland meets certain ownership and size requirements and is engaged in the commercial production under a sound management program, the land may be appraised and taxed at its present-use value (PUV) as opposed to market value.<sup>2</sup> PUV is usually much less than market value. The difference between the taxes due on the PUV and taxes that would have been payable in the absence of the special tax treatment are known as deferred taxes. When the land becomes disqualified for PUV, the deferred taxes for the current year and the three previous years with interest will usually become due and payable.<sup>3</sup>

One of the most complex parts of the PUV program is determining the ownership requirements in order to qualify for the program. The law requires that PUV property be "individually owned". Any of the following categories satisfy this definition:

- Natural person.
- Business entity – This term applies to limited liability companies, general partnerships, limited partnerships, and corporations. To satisfy the definition of "business entity", the entity must have agriculture, horticulture, or forestry as its principal business; all members of the entity must be natural persons; and all members of the business entity must be actively engaged in the principal business of the entity or be related to a member who is actively engaged in the principal business of the entity. Alternately, a member can be a relative of a decedent who met one or both of the above two conditions after the business entity had already qualified for PUV classification and from whom the member inherited his interest.
- Tenancy in common – This is a form of ownership where multiple owners (natural persons or business entities) can own individual interests in property.
- Trusts – The trust must be created by a natural person who transferred the land to the trust. Each beneficiary who is entitled to receive income or principal must be one of the following:

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<sup>1</sup> During the 2007 Session, the agricultural land classification was amended to include agricultural land used as an aquatic species farm, effective in the 2008-2009 tax year.

<sup>2</sup> Agricultural and horticultural land must also meet an income requirement: the land must have one tract that produces at least \$1,000 average gross income over the three preceding years.

<sup>3</sup> No deferred taxes are due if the property loses its classification for one of the following purposes: (1) the land is enrolled in the federal Conservation Reserve Program and is no longer in production and therefore does not meet the income requirement, (2) the land is conveyed by gift to certain exempt organizations and governmental entities. This applies to conveyances by gift to nonprofit organizations where the property will qualify for exclusion from the tax base because it is real property that will be exclusively used for educational and scientific purposes as a protected natural area, or where the property will be exclusively used for nonprofit historic preservation purpose, or (3) the property is conveyed by gift to the State, political subdivisions of the State, or the United States.

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- (a) The creator of the trust or a relative of the creator of the trust, or
- (b) A second trust whose beneficiaries (currently entitled to receive income or principal) are all either the creator of the trust or a relative of the creator of the trust.

- Testamentary trust – The trust must satisfy all of the following requirements:
  - (a) Must be created by a natural person who transferred the land to the trust.
  - (b) Land must have qualified for classification in the hands of the natural person prior to the transfer to the trust.
  - (c) At the time of the creator's death, the creator had no relatives.
  - (d) Trust income, less reasonable administrative expenses, is used exclusively for educational, scientific, literary, cultural, charitable, or religious purposes.

**BILL ANALYSIS:** In recent years, taxpayers have voiced concerns about the complexities and perceived unfairness of certain aspects of the ownership requirements for qualified farmland. In addition, county tax assessors, who must apply the PUV laws, have echoed concerns about the complexity of these requirements. Staff has met with representatives of county tax assessors, the North Carolina Association of County Commissioners, the School of Government, and the Department of Revenue to discuss these issues and to propose the following changes to the PUV ownership requirements:

- Add a definition for "farm group". A farm group is defined as a group consisting of one or more individuals who are actively engaged in agriculture, horticulture or forestry and their relatives. The term "actively engaged" includes the leasing of land.
- Change the definition of "individually owned" to mean owned by one of the following:
  - (a) Owned by an "individual". This proposed language replaces the awkward reference to "natural person".
  - (b) Owned "directly or indirectly by individuals in a farm group. An individual is considered an indirect owner if the individual is a beneficiary of a trust or a member of a business entity."<sup>4</sup> This proposed language replaces the business entity requirements.
- Deletes the definition for "tenants in common". This definition is no longer necessary because the term "directly or indirectly by individuals in a farm group" includes tenants in common.

The above changes to the definition of "individually owned" simplify the ownership requirements in the following ways:

- All members of a business entity will no longer be required to be natural persons. Instead an individual may be considered an indirect owner of the land if the individual is a beneficiary of a trust or a member of a business entity. A member is defined in current law as a shareholder of a corporation, a partner of a general or limited partnership, or a member of a limited liability company. As in current law an individual owner must still be actively engaged in the business or be a relative of an owner who is actively engaged.
- There is no longer a requirement that the business entity have its principal business in agriculture, horticulture, or forestry to qualify for PUV. However, farmland must continue to meet the requirement of commercial production, and agricultural land and horticultural land must continue to meet the income requirements. The term "principal business" is not defined in the statutes, and the deletion of this requirement will relieve the county from having to make a determination based on the weight of the evidence.

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<sup>4</sup> A "business entity" remains a corporation, a general partnership, a limited partnership, or a limited liability company.

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- Tenants in common may be individuals, business entities, or trusts. Current law requires that all tenants be qualifying natural persons or business entities.

The following are examples of land that would qualify for PUV under the proposed changes:

- A business entity applies for PUV. Four members of the business entity are individuals and one member is a trust. The sole beneficiary of the trust is a member of the business entity. (Under current law, this business entity would not qualify because the trust is not an individual.)
- Tenancy in common applies for PUV, and one of the tenants is a trust. (Under current law, the property would not qualify, because all tenants must be individuals or qualifying business entities.)
- An LLC applies for PUV, and one of the members of the LLC is a trust. All beneficiaries of the trust are children of the individual members of the LLC who own the land. (Under current law, the LLC would not qualify because the trust is not an individual.)

The property tax working group also proposes clarifying language that will allow land to remain in the PUV system if land currently in PUV is transferred to a new owner, but the deferred taxes are paid at the time the transfer occurs.

Under current law, there are several standard ownership requirements that a natural person or business entity must meet in order for their property to be in the PUV system:

- If the property is owned by a natural person, the property must meet one of the following requirements:
  1. The property is the owner's place of residence.
  2. The property has been owned by the current owner or a relative of the current owner for the four full years preceding January 1 of the year for which application is made.
  3. If transferring from a business entity or trust to the current owner, the property must have been qualified for and receiving PUV.
- If the property is owned by a business entity, the property must have been owned by the business entity or by one or more members of the business entity for the four full years preceding January 1 for which application is made.

An exception to these standard ownership requirements exists when land appraised at its PUV value is transferred to a new owner and the new owner (i) continues to use the land for its current PUV classification, (ii) files an application for PUV, and (iii) assumes the deferred taxes. However, this exception has been interpreted not to apply when the seller pays more than the current year's taxes at the time of transfer. The seller is deemed to have voluntarily removed the property from the PUV program, and the new owner may have to wait four years to qualify for PUV. The draft would allow the land to remain in PUV when the seller pays the deferred taxes at time of transfer. The new owner will become liable for subsequent deferred taxes when the land becomes disqualified.

**EFFECTIVE DATE:** The draft is effective for taxes imposed for taxable years beginning on or after July 1, 2008. Notwithstanding G.S. 105-282.1, an application submitted for the 2008-2009 tax year for the classification of land owned by a farm group is considered timely if it is filed on or before September 1, 2008.

*This summary quotes extensively from the "Present-Use Value Program" prepared by the Property Tax Division of the North Carolina Department of Revenue.*

*Draft-SMLA*